

# Business Situation

## Final Estimates for the Second Quarter of 2003

ACCORDING to the “final” estimates of the national income and product accounts (NIPAs), real GDP increased 3.3 percent in the second quarter of 2003, 0.2 percentage point more than in last month’s “preliminary” estimates (table 1 and chart 1).<sup>1</sup>

The picture of the economy shown in the final estimates is very similar to that shown in the preliminary estimates. In both sets of estimates,

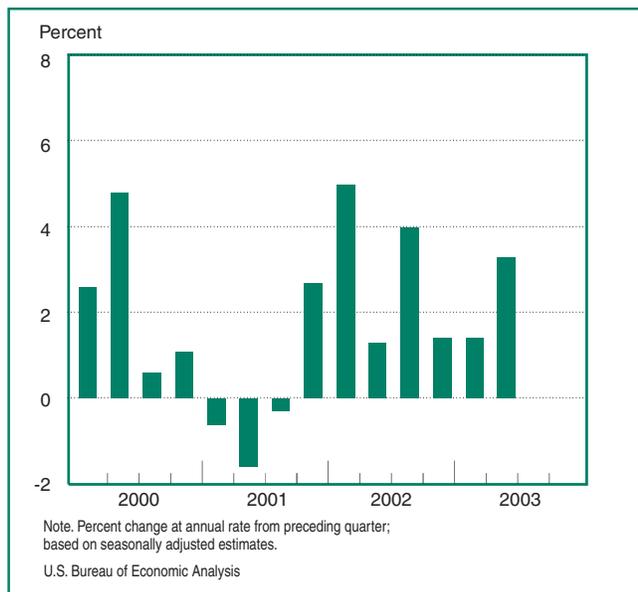
- The growth of GDP and gross domestic purchases stepped up considerably in the second quarter.
- Consumer spending and government spending contributed the most to second-quarter GDP growth and to the step-up from the first quarter to the second (table 2).<sup>2</sup>

1. Quarterly estimates in the NIPAs are expressed at seasonally adjusted annual rates, unless otherwise specified. Quarter-to-quarter dollar changes are differences between these published estimates. Percent changes are calculated from unrounded data and annualized. “Real” estimates are in chained (1996) dollars, and price indexes are chain-type measures.

2. In this article, “consumer spending” is shorthand for the NIPA series “personal consumption expenditures,” and “government spending” is shorthand for “government consumption expenditures and gross investment.” “Inventory investment” is shorthand for “change in private inventories.”

*This article was prepared by Daniel Larkins.*

**Chart 1. Real Gross Domestic Product**



- Private fixed investment increased, while inventory investment decreased.
- Prices increased much less than in the first quarter.
- Real disposable personal income (DPI) accelerated. According to the final estimates,
- Consumer spending, led by purchases of motor vehicles, contributed 2.68 percentage points to second-quarter GDP growth. Government spending, led by defense spending, contributed 1.59 percentage points.
- Nonresidential fixed investment contributed 0.74 percentage point to growth; an increase in equip-

**Table 1. Real Gross Domestic Product, Real Gross Domestic Purchases, and Real Final Sales to Domestic Purchasers**  
[Seasonally adjusted at annual rates]

	Billions of chained (1996) dollars					Percent change from preceding quarter			
	Level	Change from preceding quarter							
	2003	2002		2003		2002		2003	
	II	III	IV	I	II	III	IV	I	II
<b>Gross domestic product</b> .....	<b>9,629.4</b>	<b>93.2</b>	<b>32.6</b>	<b>33.8</b>	<b>77.4</b>	<b>4.0</b>	<b>1.4</b>	<b>1.4</b>	<b>3.3</b>
Less: Exports of goods and services	1,055.5	12.2	-16.1	-3.5	-2.6	4.6	-5.8	-1.3	-1.0
Plus: Imports of goods and services	1,601.7	12.8	28.1	-25.4	33.3	3.3	7.4	-6.2	8.8
<b>Equals: Gross domestic purchases</b> .....	<b>10,129.4</b>	<b>93.9</b>	<b>70.8</b>	<b>15.2</b>	<b>108.7</b>	<b>3.9</b>	<b>2.9</b>	<b>0.6</b>	<b>4.4</b>
Less: Change in private inventories.	-17.6	13.9	7.0	-21.0	-22.4	.....	.....	.....	.....
<b>Equals: Final sales to domestic purchasers</b> .....	<b>10,131.0</b>	<b>80.1</b>	<b>64.0</b>	<b>34.6</b>	<b>126.3</b>	<b>3.3</b>	<b>2.6</b>	<b>1.4</b>	<b>5.1</b>
Personal consumption expenditures .....	6,733.9	67.5	28.0	33.0	63.0	4.2	1.7	2.0	3.8
Durable goods .....	1,061.5	51.7	-21.8	-5.2	56.1	22.8	-8.2	-2.0	24.3
Nondurable goods .....	1,985.6	4.9	24.2	28.9	6.7	1.0	5.1	6.1	1.4
Services .....	3,728.0	20.8	20.0	7.9	13.1	2.3	2.2	0.9	1.4
Private fixed investment .....	1,615.3	-1.0	16.9	-0.6	27.4	-0.3	4.4	-0.1	7.1
Nonresidential .....	1,193.0	-2.4	6.6	-13.2	20.9	-0.8	2.3	-4.4	7.3
Structures .....	213.2	-13.5	-5.6	-1.6	2.2	-21.4	-9.9	-2.9	4.2
Equipment and software .....	999.5	15.8	14.9	-12.2	19.6	6.7	6.2	-4.8	8.3
Residential .....	412.0	1.0	8.8	9.6	6.5	1.1	9.4	10.1	6.6
Government consumption expenditures and gross investment .....	1,772.6	12.3	19.4	1.7	35.9	2.9	4.6	0.4	8.5
Federal .....	669.5	6.4	16.3	1.1	37.0	4.3	11.0	0.7	25.5
National defense .....	450.2	6.7	10.7	-3.5	40.5	6.9	11.0	-3.3	45.8
Nondefense .....	219.7	-0.2	5.6	4.5	-3.1	-0.3	11.1	8.4	-5.4
State and local .....	1,104.1	5.9	3.4	0.6	-0.5	2.2	1.2	0.2	-0.2
<b>Addendum: Final sales of domestic product</b> .....	<b>9,631.1</b>	<b>79.3</b>	<b>25.9</b>	<b>53.1</b>	<b>94.9</b>	<b>3.4</b>	<b>1.1</b>	<b>2.3</b>	<b>4.0</b>

NOTE. Chained (1996) dollar series are calculated as the product of the chain-type quantity index and the 1996 current-dollar value of the corresponding series, divided by 100. Because the formula for the chain-type quantity indexes uses weights of more than one period, the corresponding chained-dollar estimates usually are not additive. Chained (1996) dollar levels and residuals, which measure the extent of nonadditivity in each table, are shown in NIPA tables 1.2, 1.4, and 1.6. Percent changes are calculated from unrounded data. Percent changes in major aggregates are shown in NIPA table S.1. (See “Selected NIPA Tables,” which begins on page D-2 in this issue.)

ment and software was mainly responsible. Residential investment contributed 0.31 percentage point to growth, mainly on the strength of brokers' commissions on home sales. In contrast, inventory investment swung from accumulation to liquidation and subtracted 0.74 percentage point from GDP growth.

- Imports increased, subtracting 1.21 percentage points from GDP growth, and exports decreased slightly, subtracting 0.09 percentage point.
- The price index for gross domestic purchases increased 0.4 percent in the second quarter after increasing 3.4 percent in the first. The slowdown was mainly accounted for by a downturn in energy prices.
- Real DPI increased 2.6 percent after increasing 1.6 percent.

**Table 2. Contributions to Percent Change in Real Gross Domestic Product**

[Seasonally adjusted at annual rates]

	2002		2003	
	III	IV	I	II
<b>Percent change at annual rate:</b>				
Gross domestic product.....	4.0	1.4	1.4	3.3
<b>Percentage points at annual rates:</b>				
Personal consumption expenditures.....	2.93	1.19	1.40	2.68
Durable goods.....	1.74	-0.72	-0.17	1.79
Nondurable goods.....	0.22	1.01	1.21	0.28
Services.....	0.97	0.90	0.36	0.60
Gross private domestic investment.....	0.55	0.93	-0.83	0.30
Fixed investment.....	-0.03	0.65	-0.02	1.05
Nonresidential.....	-0.08	0.24	-0.47	0.74
Structures.....	-0.62	-0.25	-0.07	0.10
Equipment and software.....	0.53	0.49	-0.40	0.64
Residential.....	0.05	0.41	0.45	0.31
Change in private inventories.....	0.58	0.28	-0.82	-0.74
Net exports of goods and services.....	-0.01	-1.59	0.78	-1.29
Exports.....	0.45	-0.59	-0.13	-0.09
Goods.....	0.28	-0.82	0.13	-0.10
Services.....	0.17	0.23	-0.25	0.02
Imports.....	-0.47	-1.00	0.91	-1.21
Goods.....	-0.40	-0.71	0.81	-1.50
Services.....	-0.07	-0.30	0.10	0.30
Government consumption expenditures and gross investment.....	0.56	0.85	0.08	1.59
Federal.....	0.29	0.70	0.05	1.61
National defense.....	0.29	0.46	-0.15	1.74
Nondefense.....	-0.01	0.25	0.20	-0.13
State and local.....	0.27	0.15	0.03	-0.02

NOTE: More detailed contributions to percent change in real gross domestic product are shown in NIPA table 8.2. Contributions to percent change in major components of real gross domestic product are shown in tables 8.3 through 8.6.

## Revisions

The 0.2-percentage-point revision to second-quarter real GDP growth is close to the average revision (without regard to sign) over the past 20 years, 0.3 percentage point.

Inventory investment was revised up \$3.3 billion, mainly reflecting the incorporation of revised data from the Energy Information Administration on the coal and petroleum stocks of utilities for April and newly available data for May (table 3). As a result of the upward revision, inventory investment subtracted less (0.13 percentage point) from GDP growth in the final estimate than in the preliminary estimate.

Residential investment was also revised up, mainly reflecting the incorporation of revised data from the Census Bureau on construction put in place for May and June. As a result of the revision, residential investment added 0.10 percentage point more to GDP growth in the final estimate than in the preliminary.

The effects of the revisions to inventory investment and to residential investment were partly offset by an upward revision to imports (which are subtracted in the calculation of GDP).

The revision to imports mainly reflected the incorporation of newly available Commerce Department data on the number of international travelers for June. As a result of the revision, imports subtracted 0.12 percentage point more from GDP growth in the final estimate than in the preliminary.

The news release containing the final NIPA estimates for the second quarter also included revised estimates for several first-quarter income flows. First-quarter wages and salaries were revised down, reflecting the incorporation of the most recently available data from Bureau of Labor Statistics tabulations of private wages and salaries from the state unemployment insurance program. Personal taxes and contributions for social insurance were also revised down for the first quarter, reflecting the revisions to wages and salaries. As a result of these revisions, real disposable personal income is now

estimated to have increased 1.6 percent in the first quarter (revised down from 2.1 percent) and 2.6 percent in the second quarter (revised down from 2.8 percent).

**Table 3. Revisions to Change in Real Gross Domestic Product and Prices, Second Quarter 2003**

[Seasonally adjusted at annual rates]

	Percent change from preceding quarter		Final estimate minus preliminary estimate	
	Preliminary estimate	Final estimate	Percentage points	Billions of chained (1996) dollars
<b>Gross domestic product</b> .....	<b>3.1</b>	<b>3.3</b>	<b>0.2</b>	<b>3.9</b>
Less: Exports .....	-1.2	-1.0	0.2	0.6
Goods .....	-2.0	-1.6	0.4	0.7
Services .....	0.7	0.5	-0.2	-0.2
Plus: Imports .....	7.9	8.8	0.9	3.2
Goods .....	13.3	13.5	0.2	0.6
Services .....	-14.6	-11.4	3.2	2.1
<b>Equals: Gross domestic purchases</b> .....	<b>4.2</b>	<b>4.4</b>	<b>0.2</b>	<b>6.1</b>
Less: Change in private inventories.....				3.3
<b>Equals: Final sales to domestic purchasers</b>	<b>5.0</b>	<b>5.1</b>	<b>0.1</b>	<b>2.9</b>
Personal consumption expenditures .....	3.8	3.8	0.0	0.6
Durable goods .....	24.1	24.3	0.2	0.3
Nondurable goods .....	1.1	1.4	0.3	1.1
Services .....	1.5	1.4	-0.1	-0.6
Private fixed investment.....	6.9	7.1	0.2	0.8
Nonresidential .....	8.0	7.3	-0.7	-1.8
Structures.....	7.1	4.2	-2.9	-1.5
Equipment and software .....	8.2	8.3	0.1	0.1
Residential .....	4.5	6.6	2.1	2.0
Government consumption expenditures and gross investment.....	8.2	8.5	0.3	1.4
Federal .....	25.5	25.5	0.0	0.0
National defense .....	45.9	45.8	-0.1	-0.1
Nondefense .....	-5.4	-5.4	0.0	0.0
State and local .....	-0.7	-0.2	0.5	1.5
<b>Addenda:</b>				
Final sales of domestic product.....	4.0	4.0	0.0	0.7
Gross domestic purchases price index .....	0.2	0.4	0.2	
GDP price index .....	0.8	1.0	0.2	

NOTE: The final estimates for the second quarter of 2003 incorporate the following revised or additional major source data that were not available when the preliminary estimates were prepared.

*Personal consumption expenditures:* Revised retail sales for June and bank services data for the quarter.

*Nonresidential fixed investment:* Revised construction put-in-place for May and June.

*Residential fixed investment:* Revised construction put-in-place for May and June.

*Change in private inventories:* Revised manufacturers' and trade inventories for June, and coal and petroleum inventories of electric utilities for April (revised) and May (new).

*Exports and imports of goods and services:* International transactions accounts data on services for the first quarter (revised) and the second quarter (new).

*Government consumption expenditures and gross investment:* Revised State and local construction put-in-place for May and June.

*Wages and salaries:* Revised private wages and salaries for the first quarter, and revised employment, average hourly earnings, and average weekly hours for June.

*GDP prices:* Revised export and import prices for April through June, revised unit-value index for petroleum imports for June, and revised prices of single-family houses under construction for the quarter.

## Gross National Product

In the second quarter, real gross national product (GNP) increased 3.5 percent, 0.2 percentage point more than real GDP; real GNP increased 1.4 percent in the first quarter (table 4). GNP differs from GDP by the addition of income receipts from the rest of the world and the subtraction of income payments to the rest of the world.<sup>3</sup> In the second quarter, a small increase in receipts was more than accounted for by profits received by U.S. corporations from foreign affiliates; a decrease in payments was more than accounted for by a drop in interest income earned in the United States by foreign investors.

“Command-basis” GNP increased 4.1 percent in the second quarter after increasing 0.5 percent in the first (chart 2). This variant of GNP measures the change in the purchasing power in world markets of the goods and services that are produced by the U.S. economy—in other words, the change in the quantity of goods and services that could be purchased by the United States as a result of its current production.

Changes in command-basis GNP reflect changes in the prices of traded goods and services as summarized

3. GNP is a measure of the goods and services produced by labor and property supplied by U.S. residents, regardless of where they are located; GDP is a measure of the goods and services produced by labor and property in the United States, regardless of nationality.

**Table 4. Relation of Real Gross Domestic Product, Real Gross National Product, and Real Command-Basis Gross National Product**

[Seasonally adjusted at annual rates]

	Billions of chained (1996) dollars					Percent change from preceding quarter			
	Level		Change from preceding quarter			2002		2003	
	2003	2002	2003						
	II	III	IV	I	II	III	IV	I	II
<b>Gross domestic product</b> .....	9,629.4	93.2	32.6	33.8	77.4	4.0	1.4	1.4	3.3
Plus: Income receipts from the rest of the world .....	253.4	9.5	-3.8	-5.0	0.9	15.9	-5.7	-7.5	1.4
Less: Income payments to the rest of the world .....	255.4	1.3	-5.3	-3.8	-5.0	1.9	-7.6	-5.6	-7.4
<b>Equals: Gross national product</b> .....	<b>9,628.0</b>	<b>101.2</b>	<b>34.2</b>	<b>32.6</b>	<b>83.3</b>	<b>4.4</b>	<b>1.4</b>	<b>1.4</b>	<b>3.5</b>
Less: Exports of goods and services and income receipts from the rest of the world .....	1,304.0	22.3	-19.8	-8.9	-1.5	7.0	-5.8	-2.7	-0.5
Plus: Command-basis exports of goods and services and income receipts from the rest of the world <sup>1</sup> .....	1,327.9	20.0	-20.2	-29.2	11.7	6.1	-5.8	-8.4	3.6
<b>Equals: Command-basis gross national product</b> .....	<b>9,651.9</b>	<b>99.0</b>	<b>33.8</b>	<b>12.3</b>	<b>96.5</b>	<b>4.3</b>	<b>1.4</b>	<b>0.5</b>	<b>4.1</b>
<b>Addendum:</b>									
<b>Terms of trade</b> <sup>2</sup> .....	<b>101.8</b>	<b>-0.2</b>	<b>0.0</b>	<b>-1.6</b>	<b>1.0</b>	<b>-0.8</b>	<b>0.0</b>	<b>-6.1</b>	<b>4.0</b>

1. Exports of goods and services and income receipts deflated by the implicit price deflator for imports of goods and services and income payments.

2. The terms of trade is the following ratio, with the decimal point shifted two places to the right: In the numerator, the implicit price deflator (IPD) for the sum of exports of goods and services and of income receipts; in the denominator, the IPD for the sum of imports of goods and services and of income payments.

NOTE. See note to table 1 for an explanation of chained (1996) dollar series. Levels of these series are shown in NIPA tables 1.10 and 1.11.

by movements in the “terms of trade”—the ratio of export prices to import prices. When the terms of trade improve (that is, when export prices rise relative to import prices), the purchasing power, or command value, of U.S. GNP in international markets increases by more than the production of goods and services valued in U.S. prices.<sup>4</sup> Conversely, when the terms of trade deteriorate (that is, when export prices fall relative to import prices), the purchasing power, or command value, of U.S. GNP in international markets increases by less than the production of goods and services valued in U.S. prices.

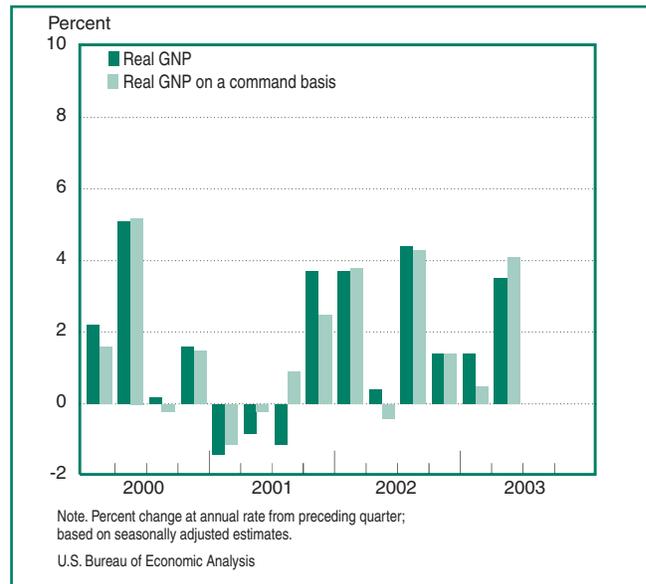
The national saving rate, which is measured as gross saving as a percentage of GNP, continued its downward trend, dropping from 13.9 percent (revised) in the first quarter to 13.7 percent in the second. The rate has declined steadily from its level of 18.5 percent in the third quarter of 2000.

4. In the estimates of command-basis GNP, the current-dollar value of the sum of exports of goods and services and income receipts is deflated by the implicit price deflator (IPD) for the sum of imports of goods and services and income payments.

The terms of trade is measured by the following ratio, with the decimal point shifted two places to the right: In the numerator, the IPD for the sum of exports of goods and services and of income receipts; in the denominator, the IPD for the sum of imports of goods and services and of income payments.

Changes in the terms of trade reflect the interaction of several factors, including movements in exchange rates, changes in the composition of the traded goods and services, and changes in producers’ profit margins. For example, if the U.S. dollar depreciates against a foreign currency, a foreign manufacturer may choose to absorb this cost by reducing the profit margin on the product it sells to the United States, or it may choose to raise the price of the product and risk a loss in market share.

**Chart 2. Real Gross National Product**



## Corporate Profits

Profits from current production increased \$80.6 billion (9.9 percent at a quarterly rate) in the second quarter (table 5).<sup>5</sup> Profits were 14.3 percent higher than a year ago.

The revised second-quarter estimate of profits is \$7.7 billion less than the preliminary estimate. Profits from the rest of the world were revised down \$7.9 billion. For domestic industries, a \$5.8 billion downward revision to profits of financial corporations was offset by a \$5.9 billion upward revision to profits of nonfinancial corporations.

Profits of domestic nonfinancial corporations increased \$70.5 billion (14.5 percent), mainly reflecting an increase in profits per unit that resulted from bigger declines in unit labor and nonlabor costs than in prices. Profits of domestic financial corporations increased \$8.4 billion (3.8 percent). Profits from the rest

of the world increased \$1.7 billion (1.6 percent), as an increase in receipts by domestic parents from their foreign affiliates was partly offset by an increase in payments by domestic affiliates to their foreign parents.<sup>6</sup>

Cash flow from current production, a profits-related measure of internally generated funds available for investment, increased \$70.8 billion.<sup>7</sup> The ratio of cash flow to nonresidential fixed investment, an indicator of the extent to which the current level of investment could be financed by internally generated funds, jumped to 92.5 percent in the second quarter from 87.4 percent in the first. The ratio had hovered in the range of 86 to 89 percent for a year and a half; during the expansion of the 1990s, it averaged 82.2 percent.

5. Profits from current production is estimated as the sum of profits before tax, the inventory valuation adjustment, and the capital consumption adjustment; it is shown in NIPA tables 1.9, 1.14, 1.16, and 6.16C (see "Selected NIPA Tables," which begins on page D-2 of this issue) as corporate profits with inventory valuation and capital consumption adjustments.

Percent changes in profits are shown at quarterly, not annual, rates.

6. Profits from the rest of the world is calculated as (1) receipts by U.S. residents of earnings from their foreign affiliates plus dividends received by U.S. residents from unaffiliated foreign corporations minus (2) payments by U.S. affiliates of earnings to their foreign parents plus dividends paid by U.S. corporations to unaffiliated foreign residents. These estimates include capital consumption adjustments (but not inventory valuation adjustments) and are derived from BEA's international transactions accounts.

7. Cash flow from current production is undistributed profits with inventory valuation and capital consumption adjustments plus the consumption of fixed capital.

**Table 5. Corporate Profits**

[Seasonally adjusted]

	Billions of dollars (annual rate)					Percent change (quarterly rate)			
	Level	Change from preceding quarter							
	2003	2002		2003		2002		2003	
	II	III	IV	I	II	III	IV	I	II
<b>Profits from current production</b> .....	<b>897.1</b>	<b>-14.0</b>	<b>25.1</b>	<b>20.4</b>	<b>80.6</b>	<b>-1.8</b>	<b>3.2</b>	<b>2.6</b>	<b>9.9</b>
Domestic industries .....	788.9	-15.0	27.1	28.0	78.9	-2.2	4.1	4.1	11.1
Financial .....	231.9	-3.4	0.3	15.9	8.4	-1.6	0.1	7.7	3.8
Nonfinancial .....	557.0	-11.7	26.8	12.1	70.5	-2.5	6.0	2.5	14.5
Rest of the world .....	108.2	1.0	-2.0	-7.6	1.7	0.9	-1.8	-6.6	1.6
Receipts (inflows) .....	196.6	12.5	1.4	5.7	3.6	7.2	0.8	3.1	1.8
Payments (outflows) .....	88.4	11.4	3.6	13.3	1.8	19.6	5.0	18.1	2.2
IVA .....	-2.2	-9.4	6.6	-18.4	24.7	.....	.....	.....	.....
CCAdj .....	199.0	-15.2	-7.9	5.6	83.7	.....	.....	.....	.....
Profits before tax .....	700.2	10.6	26.4	33.2	-27.9	1.6	3.9	4.8	-3.8
Profits tax liability .....	234.3	1.0	7.7	15.4	-3.5	0.5	3.6	6.9	-1.5
Profits after tax .....	465.9	9.5	18.7	17.7	-24.3	2.1	4.1	3.8	-5.0
<b>Profits from current production less tax liability</b> .....	<b>662.7</b>	<b>-15.0</b>	<b>17.4</b>	<b>4.9</b>	<b>84.1</b>	<b>-2.6</b>	<b>3.1</b>	<b>0.9</b>	<b>14.5</b>
Cash flow from current production .....	1,035.5	-12.0	14.0	-4.0	70.8	-1.2	1.5	-0.4	7.3
<b>Domestic industry profits:</b>									
Corporate profits of domestic industries with IVA .....	589.9	0.2	35.0	22.4	-4.8	0.0	6.5	3.9	-0.8
Financial .....	226.6	-2.4	0.4	13.8	-3.7	-1.1	0.2	6.4	-1.6
Nonfinancial .....	363.3	2.6	34.6	8.6	-1.1	0.8	10.8	2.4	-0.3
Manufacturing .....	106.9	8.6	8.4	13.1	-15.1	9.3	8.4	12.0	-12.4
Transportation and public utilities .....	33.8	-3.9	8.3	-1.4	13.7	-22.9	63.2	-6.3	68.2
Wholesale trade .....	57.3	-0.3	14.4	-7.5	5.9	-0.7	32.4	-12.7	11.6
Retail trade .....	85.9	-3.5	-7.4	-0.3	11.1	-4.0	-9.0	-0.4	14.9
Other .....	79.3	1.7	10.9	4.6	-16.8	2.2	13.5	5.0	-17.5
		Dollars							
<b>Unit price, costs, and profits of nonfinancial corporations:</b>									
Unit price .....	1.037	-0.001	0.002	0.002	-0.002	.....	.....	.....	.....
Unit labor cost .....	0.671	-0.001	-0.001	0.000	-0.007	.....	.....	.....	.....
Unit nonlabor cost .....	0.265	0.002	0.000	-0.002	-0.004	.....	.....	.....	.....
Unit profits from current production .....	0.102	-0.003	0.005	0.001	0.012	.....	.....	.....	.....

NOTE: Levels of these and other profits series are shown in NIPA tables 1.14, 1.16, 6.16C, and 7.15.  
IVA Inventory valuation adjustment  
CCAdj Capital consumption adjustment

**Profits with inventory valuation adjustment (IVA).** The current-production measure of profits is not available at the detailed industry level, because estimates of the capital consumption adjustment (CCAdj) do not exist at this level. (CCAdj is only available for total financial and total nonfinancial industries.) Consequently, industry profits are best measured by profits with IVA.

In the second quarter, profits with IVA and profits from current production diverged sharply, reflecting a sharp divergence in the measures of depreciation that underlie them. As was explained in more detail last month, the Jobs and Growth Tax Relief Reconciliation Act of 2003 (signed into law on May 28, 2003) increased the immediate depreciation writeoff that corporations could claim for property acquired after May 5, 2003, and placed in service before January 1, 2005.<sup>8</sup> As a result, the measure of depreciation used for tax accounting (and for profits with IVA) increased by an estimated \$75.2 billion at an annual rate in the second quarter.<sup>9</sup> In contrast, the measure of depreciation that underlies profits from current production was not affected by the tax act; this measure of depreciation approximates the value of fixed capital actually used up in the production process. Reflecting the differing impact of the tax act on the two measures of depreciation, and in contrast to the sharp increase in profits from current production, profits with IVA decreased.

For financial industries, profits with IVA decreased

\$3.7 billion. The decrease was mainly accounted for by commercial banks.

For nonfinancial industries, profits with IVA decreased \$1.1 billion. Decreased profits in manufacturing and in “other” nonfinancial corporations were largely offset by increased profits in the transportation and utility group and in wholesale and retail trade (chart 3). In manufacturing, decreases were widespread; the largest were posted by manufacturers of motor vehicles and of chemicals. In “other” nonfinancial corporations, most of the decrease was accounted for by services (which includes business services and health services).

The increase in the transportation and utilities group was mainly accounted for by a jump in airline profits in response to stepped-up subsidies provided for by the Emergency Wartime Supplemental Appropriations Act of 2003. The increase in retail trade was mostly accounted for by general merchandise stores and auto dealers.

**Profits before and after tax.** Profits before tax (PBT) decreased \$27.9 billion in the second quarter, and profits tax liability decreased \$3.5 billion.<sup>10</sup> As a result, profits after tax (PBT less profits tax liability) decreased \$24.3 billion. In contrast, profits from current production less profits tax liability increased \$84.1 billion.

8. “Business Situation,” SURVEY OF CURRENT BUSINESS 83 (September 2003): 13–14.

9. At a quarterly rate, depreciation increased \$18.8 billion.

10. Profits before tax is based on inventory and depreciation practices used in tax accounting, whereas the current-production measure—which excludes nonoperating items, such as special charges and capital gains and losses—is based on depreciation of fixed assets and inventory withdrawals valued at current cost.

**Chart 3. Corporate Profits with Inventory Valuation Adjustment: Change from 2003:I to 2003:II**

